

*Example.* On Day 1, Customer A uses a payment card to purchase \$100 worth of goods from Merchant B. Bank X, the merchant acquiring entity for B, is the party with the contractual obligation to make payment to B in settlement of the transaction. On Day 2, X, after deducting fees of \$2, makes payment of \$98 to settle the transaction for the sale of goods from B to A. Under paragraph (a)(6) of § 1.6050W–1, X must report the amount of \$100, the amount of the transaction on Day 1, without any reduction for fees or any other amount, as the gross amount of this reportable payment transaction on the annual information return filed under paragraph (a)(1) of § 1.6050W–1. Under paragraph (c)(1) of this section, X's obligation, if any, to backup withhold arises on Day 1, the backup withholding obligation must be satisfied on Day 2, and the amount subject to backup withholding is \$100 (the gross amount of the reportable payment transaction (as defined in paragraph (a)(6) of § 1.6050W–1)).

(d) *Backup withholding from an alternate source*—(1) *In general.* A payor may not withhold under section 3406 from a source maintained by the payor other than the source with respect to which there exists a liability to withhold under section 3406 with respect to the payee. See section 3403 and § 31.3403–1, which provide that the payor is liable for the amount required to be withheld regardless of whether the payor withholds.

(2) *Exceptions for backup withholding when there are no funds available*—(i) *Backup withholding from an alternative source.* In the event there are no funds available in the source with respect to which there exists a liability to withhold under section 3406 with respect to the payee, the payor may withhold under section 3406 from another source maintained by the payee with the payor. The source from which the tax is withheld under section 3406 must be payable to at least one of the persons listed on the account subject to withholding. If the account or source is not payable exclusively to the same person or persons listed on the account subject to withholding under section 3406, then the payor must obtain a written statement from all other persons to whom the account or source is payable authorizing the payor to withhold under section 3406 from the alternative account or source. A payor that elects to withhold under section 3406 from an alternative source may determine the

account or source from which the tax is to be withheld, or may allow the payee to designate the alternative source.

(ii) *Deferral of withholding.* If the payor cannot locate, with reasonable care (following procedures substantially similar to those set forth in § 31.3406(d)–5(c)(3)(ii)(A) and (B)), an alternative source of cash from which the payor may satisfy its withholding obligation pursuant to paragraph (d)(2)(i) of this section, the payor may defer its obligation to withhold under section 3406 until the earlier of—

(A) The date on which cash, in a sufficient amount to satisfy the obligation in full, is deposited in the account subject to withholding under section 3406; or

(B) The close of the fourth calendar year after the obligation arose.

(iii) *Termination of obligation to backup withhold.* If, at the close of the fourth calendar year after the backup withholding arose, the payor has not located an alternate source of cash from which the payor may satisfy its withholding obligation, and sufficient cash to satisfy the obligation in full has not been deposited in the account subject to withholding under section 3406, then the obligation to backup withhold terminates at the close of the fourth calendar year.

(e) *Effective/applicability date.* The provisions of this section apply to amounts paid after December 31, 2011.

[T.D. 9496, 75 FR 49835, Aug. 16, 2010]

#### **§ 31.3406(b)(4)–1 Exemption for certain minimal payments.**

(a) *In general.* A payor of reportable interest or dividends (as described in section 3406(b)(2)) or of royalties (as described in section 3406(b)(3)(E)) may elect not to withhold from a payment that does not exceed \$10 and that on an annualized basis does not exceed \$10 (see paragraph (c) of this section). A broker or barter exchange may elect not to withhold on gross proceeds of \$10 or less without regard to the annualization requirement. See § 31.6051–4 for the requirement to furnish a statement to the payee if tax is withheld under section 3406.

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(b) *Manner of making the election.* The election not to withhold from payments that do not exceed \$10 can be made only for payments described in paragraph (a) of this section. The election may be made on a payment-by-payment basis.

(c) *How to annualize*—(1) *In general.* To annualize a reportable interest payment, dividend payment, or royalty payment, a payor must calculate what the amount of the payment would be if it were paid for a 1-year period (instead of the period for which it actually is paid). The annualized amount is determined by dividing the amount of the payment by the number of days in the period for which it is being paid and then multiplying that result by the number of days in the year. If the annualized amount is \$10 or less, the payor may elect not to withhold on that payment regardless of whether more than \$10 may be or has been paid to the payee in other reportable payments during the calendar year. Conversely, if the annualized amount is more than \$10, withholding applies even if \$10 or less is actually paid to the payee during the calendar year. For purposes of computing the annualized amount, the payor may assume that February always consists of 28 days and that the year always consists of 360 days. For amounts that are deposited with a payor in a new account or certificate between the dates on which the payor customarily pays or credits interest, the payor may assume that the period for which the interest is paid is the payor's customary period for paying or crediting interest.

(2) *Special aggregation rule for reportable interest and dividends.* If a payor maintains records that reflect multiple holdings of one payee and the payor makes an aggregate payment of reportable interest or dividends (as defined in section 3406(b)(2)) with respect to those multiple holdings (such as a dividend check that reflects payment on all stock owned by the payee), the payor must annualize the aggregate payment.

(d) *Exception for window transactions and original issue discount.* A payor is not required to annualize payments made in window transactions (as defined in § 31.3406(b)(2)-3(b)) or payments of original issue discount. With respect

to a window transaction, however, the payor is required to aggregate all payments made in the same transaction (e.g., payments made with respect to coupons or obligations presented for payment at the same time as described in § 1.6049-4(e)(4) of this chapter).

[T.D. 8637, 60 FR 66119, Dec. 21, 1995]

### § 31.3406(c)-1 Notified payee underreporting of reportable interest or dividend payments.

(a) *Overview.* Withholding under section 3406(a)(1)(C) applies to any reportable interest or dividend payment (as defined in section 3406(b)(2)) made with respect to an account of a payee if the Internal Revenue Service or a broker notifies a payor under paragraph (c) (1) or (2) of this section that the payee is subject to withholding due to notified payee underreporting (as defined in paragraph (b)(1) of this section), and the payor is required under paragraph (c)(3) of this section to identify that account. After receiving the notice and identifying accounts, the payor must notify the payee, in accordance with paragraph (d) of this section, that withholding due to notified payee underreporting has started. Paragraph (e) of this section describes the period for which withholding due to notified payee underreporting is required. Paragraph (f) of this section provides rules concerning notices that the Internal Revenue Service will send to a payee before notifying a payor that the payee is subject to withholding due to notified payee underreporting. Paragraph (g) of this section provides rules that a payee can use to prevent withholding due to notified payee underreporting from starting or to stop it once it has started. Paragraph (h) of this section provides special rules for joint accounts of payees who have filed a joint return. See section 6682 for the penalties that may apply to a payee subject to withholding under section 3406(a)(1)(C).

(b) *Definitions*—(1) *Notified payee underreporting.* Notified payee underreporting means that the Internal Revenue Service has—

(i) Determined that there was a payee underreporting (as defined in paragraph (b)(2) of this section);